1993

Broadcast International, Inc. v. Utah State Tax Commission : Reply Brief

Utah Court of Appeals

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BRIEF

DOCKET NO. 930527

IN THE UTAH COURT OF APPEALS

BROADCAST INTERNATIONAL, INC.	)	
	)	
Petitioner,	)	Case No. 93-0527-CA
	)	
v.	)	
	)	
UTAH STATE TAX COMMISSION,	)	Priority No. 14
	)	
Respondent.	)	

REPLY BRIEF OF PETITIONER

ON WRIT OF REVIEW OF FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECISION OF THE UTAH STATE TAX COMMISSION

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Pursuant to Rule 24(c) of the Utah Rules of Appellate Procedure, Petitioner Broadcast International ("Broadcast") submits this Reply Brief in response to the Brief of Respondent Utah State Tax Commission ("Tax Commission"). Broadcast believes many of Tax Commission's arguments are extremely unfair, and that twenty-five pages is inadequate to respond to the sheer volume of specious arguments. For that reason, this brief concentrates on the most egregious of the Tax Commission's arguments. Broadcast rests on its initial brief as a reply to those arguments not otherwise addressed herein.

ISSUES PRESENTED FOR REVIEW

Broadcast disputes the Tax Commission's framing of ISSUE 1 and ISSUE 4 as stated in Respondent's brief.

The quintessential holding of the Tax Commission's Final Decision is that Broadcast did not grant its subscribers the right to possession, operation or use of its equipment. This ruling is part of the Decision and Order and is not a Finding of Fact. Final Decision at 11. Refusing to accept their own client's framing of the issues, the Tax Commission's lawyers attempt to recast ISSUE 1 as an issue of fact ("whether the Tax Commission's determination is supported by substantial evidence") rather than law, in an apparent attempt to trigger this Court's deference to the Tax Commission's Final Decision as a finding of fact. This stratagem impliedly assumes that (1) there are disputed facts; and (2) the definition of "sale" in Section 59-12-102(10) fluctuates with each different fact pattern.[1]

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[1] As demonstrated infra, a recurrent problem with the Tax Commission's brief is its obvious departure from the Tax Commission's Final Decision.

Both assumptions are false. Broadcast accepted the Tax Commission's Findings of Fact. Petitioner's Brief at 5. There are, therefore, no disputed material facts and the Tax Commission lawyers' attempt to manipulate "ISSUE 1" from a legal issue into a factual one should be rejected.

Based upon uncontroverted facts, the Tax Commission's Final Decision (again distinguished from the Tax Commission's brief on this appeal) framed the primary issue as follows:

> Broadcast's purchase of equipment from Utah vendors is not subject to sales and use tax under 59-12-102(1)(a) if purchased for resale. In the context of this case, Broadcast can only establish such a resale by showing that it granted the subscribers the right to possession, the right to operate, or the right to use such equipment.
>
> Decision and Order at 11 (emphasis added).

Broadcast agrees with this framing of the issue. Petitioner's Brief at 13. Broadcast also agrees that resolution of this issue depends upon whether Broadcast granted its subscribers a "right to possession, operation or use" of its equipment, within the meaning of Section 59-12-102(10)(e). If so, Broadcast's initial purchases are nontaxable purchases for resale.

Because the Utah Legislature has not explicitly vested the Tax Commission with discretion to interpret Section 59-12-102(10)(e), there is no menu of permissible legal interpretations. Rather, there is a correct legal definition for "right to possession, operation or use" which must be applied to undisputed facts. Hence, ISSUE 1 is an issue of law, not an issue of fact.

"ISSUE 4" as stated in the Tax Commission's brief - whether the negligence penalty is justified - is a legal, not a factual

issue, because the Tax Commission's Final Decision does not mention, much less apply, the appropriate legal standard in deciding whether Broadcast was "negligent" in "failing to pay" the assessed sales and use taxes. Following Chicago Bridge & Iron Co. v. State Tax Commission, 839 P.2d 303 (Utah 1992), the Tax Commission should have, but did not, ask whether Broadcast maintained a "good faith" doubt concerning the taxability of its transactions. Id. at 309.

DETERMINATIVE STATUTES

Broadcast relies upon the same statutes cited in its initial brief, primarily Utah Code Ann. § 59-12-102(10). These statutes are included in Appendix A.

STANDARD OF REVIEW

Having miscast the issues, the Tax Commission misstates the standard of review. The Tax Commission argues that Utah Code Ann. 59-1-610 (1)(b)(1993), which mandates a "correction of error" standard for reviewing the Tax Commission's conclusions of law, (except in narrow circumstances) does not apply to this case. The Tax Commission urges this Court to adopt instead an "intermediate standard of review" (i.e. "to assure that the agency's findings fell within the bounds of reasonableness") because this case "involves both factual findings and legal conclusions." Respondent's Brief at 2.

The Tax Commission's argument is preposterous and should be rejected out of hand for several reasons. First, as explained above, almost all the issues in this case are issues of law arising from uncontroverted or uncontrovertible facts, which should be reviewed under a "correction of error" standard. See Savage

Industries Inc. v. Utah State Tax Commission, 811 P.2d 664 (Utah 1991).[2]

Second, and more important, by arguing that this case raises "mixed questions of law and fact" calling for an intermediate standard of review, the Tax Commission seriously misapprehends the Utah Administrative Procedures Act ("UAPA"), Utah Code Ann. 63-46b-1 through 24 and the new amendments to the Tax Court Act, Utah Code Ann. 69-1-610(1) and (2) (1993).[3]

Since 1988, UAPA Section 63-46b-10 has provided that the agency head, following a formal hearing, must enter its "findings of fact" and "conclusions of law." Consequently, there was no need for Section 59-1-610(1) to specify a standard for reviewing "mixed findings of fact and conclusions of law" when the Tax Commission, under UAPA, is not authorized to enter them.

Moreover, there are no longer common law standards for judicial review, as the Tax Commission argues on the basis of an obsolete 1983 case, Utah Department of Administrative Services v.

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[2] The only issue that should not be reviewed under a "correction of error" standard in this case is ISSUE 5, which is "Whether the Tax Commission erred in finding that Broadcast sold tangible personal property to Osmond rather than a nontaxable service." Both parties agree ISSUE 5 raises an issue of fact to which this Court should apply a "substantial evidence" standard. Petitioner's Brief at 2.

[3] Utah Code Ann. § 59-1-610(1) provides:

> (1) When reviewing formal adjudicative proceedings commenced before the commission, the Court of Appeals or the Supreme Court shall:
>
> (a) grant the commission deference concerning its written findings of fact, applying a substantial evidence standard on review; and
>
> (b) grant the commission no deference concerning its conclusions of law, applying a correction of error standard, unless there is an explicit grant of discretion contained in a statute at issue before the appellate court.
>
> (Emphasis added.)

Public Service Commission, 658 P.2d 601 (Utah 1983). Respondent's Brief at 2. "UAPA upset these previously settled standards." SEMECO Industries, Inc. v. Utah State Tax Commission, 849 P.2d 1167, 1170 (Utah 1993) (Durham J., dissenting).

Further, newly enacted Section 59-1-610(1) states that the "correction of error" standard "shall" be applied to the Tax Commission's "conclusions of law" unless the statute at issue includes an explicit grant of discretion to the Commission (which both parties in this case acknowledge is absent). Section 59-1-610(2) states that the "correction of error" standard supersedes the otherwise applicable UAPA standards for review. Perforce, Section 59-1-610(1) supersedes the 1983 common law standards of review which the Tax Commission urges this Court to apply.[4]

STATEMENT OF FACTS

The Tax Commission's Statement of Facts, as authored by the Tax Commission lawyers in Respondent's Brief, is strikingly different from the Tax Commission's Findings of Fact stated in its Final Decision. Broadcast accepted the Final Decision's Findings of Fact. Petitioner's Brief at 5. In summary, the salient facts are that Broadcast, pursuant to contract, provides broadcasting

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[4] The Tax Commission's interpretation of Section 59-1-610(1) finds no support in recent case law. In Miller Welding Supply, Inc. v. Utah State Tax Commission, 860 P.2d 361 (Utah 1993), this Court, without discussion, applied the "correction of error" standard mandated in Section 59-1-610(1) to the Tax Commission's interpretation of Section 59-12-102(4)(a)(iii) of the Sales and Use Tax Act, which makes purchases of "oxygen" exempt. In OSI Industries v. Utah State Tax Commission, 860 P.2d 381 (Utah 1993), this Court applied the same "correction of error" standard retroactively to the Tax Commission's interpretation of Section 59-12-104(20) of the Sales and Use Tax Act, which makes purchases of "sprays and insecticides" exempt from sales taxes. In Knowledge Data Systems v. Utah State Tax Commission, 1993 WL 533784 (Utah App.), this Court applied the "correction of error" standard to the Tax Commission's interpretation of Section 59-12-103(14) of the Sales and Use Tax Act, which makes "isolated and occasional sales" exempt from taxation. The Tax Commission was reversed in all three cases.

services (i.e. background music, in-store commercials, teleconferencing, "E" mail, etc.) to its subscribers (typically large retail chains like Safeway) via electronic equipment (i.e. receivers, satellite dishes and printers) which Broadcast installs on and in the subscriber's stores. See Final Decision, Findings of Fact 1 through 28.

On appeal, the Tax Commission lawyers, again ignoring their own client's Findings of Fact, recite a litany of largely irrelevant facts in an apparent attempt to mislead this Court. Some examples follow:

1. Statement of Facts, paragraphs 7, 8, 14, 15, 16, and 20 stress that title to the equipment remained with Broadcast. The apparent intent in hammering this fact is to imply that a sale from Broadcast to its subscriber could not have occurred because title never passed. The Tax Commission's Auditing Division repeatedly made this argument below, two auditors ignorantly claiming that under Utah law title had to pass for a taxable sale to occur.[5]

Conclusively, under Section 59-12-102(10)(e), a sale, for sales and use tax purposes, occurs if the "right to possession,

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[5] Q. [By Mr. Miller] Let me ask you the question. What is possession?

A. [By Ms. Andersen] Possession, to me, means ownership.

Q. It means ownership?

A. Yes, if I possess something, I own it.

Deposition of Anna Andersen at 16. When shown this definition of "possession" was irreconcilable with the Tax Code, Ms. Andersen suddenly changed her testimony, stating, "I'm telling you that my own definition of possession means ownership. But in context of the Code, possession means the right to use and control." Id. at 17. Even this definition of "possession" is wrong because Section 59-12-102(10)(e) states "possession, operation or use" meaning that "use" and "operation" are not synonymous with "possession." Auditor Michael Kenney, who made the decision to tax Broadcast (deposition of Michael Kenney at 7) also stated that "I'd say that if they [Broadcast] transferred title is an important part." Id. at 17.

operation or use" of tangible personal property is transferred pursuant to contract or lease, even if title is not. The Tax Commission's incessant harping over the lack of title passage thus misleads this Court.

2. The Tax Commission's Statement of Facts, paragraphs 5 and 6, observe that the "receivers" are "passive" devices in that once properly tuned they seldom need to be physically manipulated by the subscriber. The apparent implication of this fact is that Broadcast's subscribers do not "possess" this equipment, as if the "right to possession, operation or use" under Section 59-12-102(10)(e) required physical manipulation of the equipment. There is no legal authority or logical basis for such a position. Consequently, the Tax Commission's persistence in stressing that the receivers were "passive" devices misleads this Court.

Most important, the Tax Commission's legal conclusion, that Broadcast's subscribers had no right to possession, is flatly irreconcilable with what the Senior Tax Auditor of the case, Rick Mitchell, admitted.[6]

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[6] Q [by Mr. Miller] Now, I asked you a moment ago whether the subscriber had a right to possession, operation or use, and you told me you thought they had control of that tangible personal property.

A [by Mr. Mitchell] I believe so.

Q Do they have possession of it?

A Yes.

Q Do they operate it?

A They say they do, yes, I've never seen one.

. . . .

Q Tell me, then what's missing? I guess I don't understand. We've already established that it is a transaction. We've already established that the subscriber has the right to possession,

3. The Tax Commission's Statement of Facts is also misleading because it attempts to disguise legal arguments as facts. In paragraph 11, for instance, the Tax Commission states that "To be consistent with its 'resale' theory, Broadcast should have collected sales tax on the entire subscription fee since Broadcast did not itemize the cost of the equipment in the service agreements." Respondent's Brief at 7. That is an incompetent and incorrect legal argument Auditor Rick Mitchell made at the formal hearing. Hearing Tr. 338, lines 1-15. It is not a statement of fact. Mr. Mitchell's legal argument would only be true under a lease calling for a stream of payments. It ignores a grant of rights under a "contract" which may not require a stream of payments for the equipment. Even assuming Mr. Mitchell was correct as to Utah law, Mr. Mitchell is incompetent to testify as to the law of other states, which would be applied to well over 95% of the transactions at issue in this case.[7]

4. Paragraph 12 of the Tax Commission's Statement of Facts is misleading because it implies that Broadcast itself must have consumed the equipment (and hence owed Utah use taxes) since Broadcast checked the "goods consumed" box on its sales tax license form. This conclusion follows only by indulging a giant leap of

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> operation and use. And I think we have agreed that this equipment is tangible personal property. And we have agreed it is a contract.
>
> **A** Right.

Deposition of Rick Mitchell at 12 and 13.

[7] See Hearing Tr. at 362 in which the Hearing Officer, Mr. Hennebold, ruled that Mr. Mitchell's colleague Anna Andersen was incompetent to testify as to the law of other states. Mr. Hennebold stated, "It seems to me there is no ability for her to testify, no competence on that."

logic. The "goods consumed" box was inclusive of many Broadcast purchases (offices supplies, furniture, etc.) for which Broadcast paid a Utah sales or use tax. Testimony of Reese Davis, Hearing Tr. at 127, 129.

Paragraph 12 also implies the equally ludicrous assumption that an audit deficiency against Broadcast can be justified upon what box Broadcast checked on a sales and use tax license form, rather than what actually transpired between Broadcast and its subscribers and what they intended.[8]

5. A similar point should be made about paragraph 13 in which the Tax Commission states that Broadcast told the jurisdictions in which its subscribers operated that Broadcast would pay any use tax due on its equipment. The implied conclusion here is that Broadcast was the end user of such equipment. The undisputed facts are inapposite. Broadcast was contractually bound to pay all applicable sales and use taxes the subscriber would have incurred for its use of the equipment. Testimony of Reed Benson, Hearing Tr. at 229, 230, 240 and 243.

6. Paragraphs 19 and 20 state that Broadcast was required to maintain the equipment and that it had the right to remove or replace it. From those statements, the implied conclusion is that because Broadcast has rights in the equipment the subscribers have none. This argument is absurd. Broadcast had rights in its own equipment like a lessor has rights in its tangible personal property. Irrespective of whatever rights Broadcast retains, the

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[8] A basic premise of tax law is that transactions should be taxed in accordance with their economic substance and not their form. Gregory v. Helvering, 293 U.S. 465 (1935).

subscribers have certain rights including the "right to possession, operation or use" of the equipment granted to them under a contract. Both parties to the agreement -- Broadcast and its subscriber -- so testified.[9]

7. Finally, Broadcast's sole maintenance obligation for the equipment, noted in Paragraph 20, has no conceivable relevance in deciding whether Broadcast granted the "right to possession, operation or use" of the equipment to its subscribers, which is this Court's exclusive concern in deciding the primary issue of this case. Paragraph 20 also omits those facts which demonstrate that the subscribers had substantial rights to and obligations for the equipment, such as the subscriber's obligation to bear the risk of loss for damage to the equipment. Testimony of Dwight Egan, Hearing Tr. at 55.

ARGUMENT

I. THE TAX COMMISSION DISTORTS GENERAL LEGAL PRINCIPLES AND PRECEDENT TO TAX BROADCAST FOR SALES MADE TO OUT-OF-STATE SUBSCRIBERS.

A. The Tax Commission's theory for taxing Broadcast wrongly presupposes that (1) Broadcast's claim rests exclusively upon an "exemption" rather than an "exclusion" from taxation; and that (2) the Tax Commission may interpret statutes "to its satisfaction."

The Tax Commission's first argument under point I of its brief is based upon two mistaken premises. The argument is that Broadcast must pay sales taxes upon its purchases unless "it can prove to the satisfaction of the Commission that an exemption

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[9] As subscriber John Lasater from SaveMart testified, "SaveMart views the word possession as the fact that we have the equipment secured at our store locations. We physically have the equipment." Hearing Tr. at 106. "We use the equipment. It operates for us." Id.

applies." Respondent's Brief at 12 (emphasis added). An initial nonsequitur with this argument is that it wrongly presupposes that all sales of tangible personal property are taxable absent some exemption. Section 59-12-102(8)(a) of the Utah Sales and Use Tax Act expressly excludes the "resale of . . . [tangible personal] property" from the definition of "Retail sale," which means that "sales for resale" are not part of the tax base. Likewise the definition of "storage" in Section 59-12-102(12) excludes a "sale made in the regular course of business" from the tax base.

In addition, "sales for resale" qualify for the exemption under Section 59-12-104(28). Because Sections 59-12-102(8)(a) and Section 59-12-102(12) establish the tax base, they are taxing statues, not exemptions,[10] and must be construed in favor of the taxpayer and strictly against the taxing authority.[11] See, e.g., Pacific Intermountain Express v. Utah State Tax Commission, 329 P.2d 650, 651 (Utah 1958) ("taxing statutes are to be construed strictly, and in favor of the taxpayer where doubtful."); Merrill Bean Chevrolet, Inc. v. State Tax Commission, 617 P.2d 397, 398 (1980) ("we have also held taxing statutes, where doubtful, are to be construed strictly, and in favor of the taxpayer."); Parson Asphalt Products, Inc. v. State Tax Commission, 617 P.2d 397, 398 (1980) ("even though taxing statutes should generally be construed

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[10] Even under a Section 59-12-104(28) "strict construction" analysis, Broadcast's initial purchases are exempt because they are purchases for resale based upon Section 59-12-102(10)(e)'s definition of sale.

[11] The Tax Commission's strategy for dealing with this argument has simply been to ignore Section 59-12-103(8)(a), Section 59-12-103(1) and the cases cited above as if they neither existed nor said what they say.

favorable to the taxpayer and strictly against the taxing authority . . .").

A second and more damaging defect in the Tax Commission's first argument is its assertion that statutes may be interpreted to its "satisfaction," as if the Tax Commission were a beneficent king. There is no authority for this assertion. To the contrary, many cases decided in the past year expressly hold that the Tax Commission does not have discretion to interpret the Utah Sales and Use Tax Act. See cases cited in footnote 4.

B. The Tax Commission's reliance on Nucor Corp. distorts the facts and holding of that case.

Another fatal flaw in the Tax Commission's argument is its tortuous reading of Nucor Corp. v. Utah State Tax Commission, 832 P.2d 1294 (Utah 1992). To begin, the Tax Commission correctly states the Utah Supreme Court concluded in Nucor that "'purchase for resale' implies that a company's purpose in buying an item must be to resell that item." Respondent's Brief at 13 quoting Nucor at 1296. However, this unexceptional observation begs the question in this case as to whether Broadcast had such a resale intent when it initially purchased the equipment.

The Tax Commission's brief on appeal (again as distinguished from the Tax Commission's Final Decision which makes no such finding) contends that Broadcast had no resale intent because "Nucor [Broadcast in this instance] purchased the items at issue primarily for their use as equipment and only incidentally for their use as ingredients in the manufacturing process." Respondent's Brief at 13 (second emphasis added)." The fallacy of this contention is twofold.

One, it simply assumes, again without evidence, that Broadcast purchased the equipment for its own use. The uncontroverted facts are inapposite. The equipment at issue simply passed through Utah, in unopened boxes, to the out-of-state subscriber sites. Broadcast gave its vendors an exemption certificate thereby evincing its resale intent. Final Decision at 5, paragraph 22.

Two, Nucor's facts, which compelled the Supreme Court's holding, are alien and dissimilar to the facts in this case. Nucor "used" the items at issue "as ingredients" in its "manufacturing" process. The equipment Broadcast purchased simply sat in unopened boxes until deployed out of state. Broadcast manufactures nothing. Its equipment does not become an "ingredient" for anything. Broadcast simply installs the equipment without alteration on the subscriber premises.

C. The Tax Commission's legal rationale has been ever-shifting, but always to Broadcast's detriment.

In this case, the ever-shifting rationale for taxing Broadcast has subjected it to unconscionable unfairness. For example, the Tax Commission:

(1) initially issued an audit deficiency under one theory. The auditors simply assumed the equipment Broadcast purchased was taxable as "goods consumed." The auditors never bothered to inquire about a defense under Section 59-12-102(10)(e),[12] even

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[12] Rick Mitchell testified:

> Q [By Mr. Miller] Did you ask them whether the right to possession, operation or use was transferred by their contract or sales service agreement?
>
> A [By Mr. Mitchell] No we did not.

though "Broadcast [contemporaneously] provided an exemption certification stating that the receivers were being purchased for resale." Final Decision at 5, paragraph 22;

(2) prosecuted the audit deficiency under another theory. In light of Mr. Mitchell's admissions, uncontrovertible testimony, and common sense that Broadcast subscribers had the "right to possession, operation or use" of the equipment, the Attorney General nonetheless concocted arguments that Broadcast retained "beneficial possession" of the equipment, and that none of the 800 jurisdictions outside Utah could tax the subscribers (even though all of them did) because "it would involve the transfer of . . . property across state lines . . .";[13]

Q Did you ask them whether the subscribers had possession?

A No.

Q And you didn't ask them about operation or use either did you?

A That's correct.

Hearing Tr. at 339.

[13] Anna Andersen testified:

Q [by Mr. Miller] Were you aware that in that memorandum [filed by the Auditing Division] the argument is made that Broadcast has, quote, beneficial possession, unquote, of this equipment?

A [by Ms. Andersen] I didn't read it carefully enough to even remember seeing the word beneficial possession.

Q So that's not a concept you came up with?

A No.

Hearing Tr. at 371. See Memorandum in Opposition to Broadcast's Motion for Summary Judgment at 5, and in Support of Auditing Division's Motion for Summary Judgment at 4.

(3) decided the case under another theory. The Tax Commission's Final Decision holds that Broadcast "did not grant" its subscribers a right to possession, operation or use of the equipment. Final Decision at 11; and

(4) resurrected a theory on appeal that Broadcast "used" its own equipment, even though the Final Decision makes no such finding. This argument flies in the face of Chet Paulsen's uncontroverted testimony that the equipment simply passed through Utah "fully assembled," "packaged in individual boxes," and that the equipment was shipped outside Utah to the subscribers, usually within 24 hours, still in the original crates. Hearing Tr. at 277.[14] The Tax Commission's ever-shifting rationale for taxation evinces an unlawful pro-tax bias against Broadcast.[15]

II. THE TAX COMMISSION'S BRIEF, AS DISTINGUISHED FROM ITS FINAL DECISION, TWISTS THE UNDISPUTED FACTS TO JUSTIFY TAXATION.

Having ignored the definition of "Retail sale" in Section 59-12-102(8), distorted Nucor and shifted the justification for taxation, the Tax Commission then argues under Point I of its brief that the "facts" recited between pages 13 and 17 of its brief "support the findings of the Tax Commission . . ." Respondent's Brief at 17. This argument is astounding because almost none of

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[14] It also ignores the holding in Knowledge Data Systems v. Utah State Tax Commission, 1993 WL 533784 (Utah App.) because Broadcast's purchase of the equipment and its subsequent deployment of the equipment by grant of possession to the subscribers is "inexorably linked" and should be viewed as one transaction.

[15] Broadcast is entitled to rely upon the Tax Commission's Final Decision as the justification for taxation. To hold otherwise would be to violate Broadcast's rights under UAPA. See UAPA Section 63-46b-16 which states that the appellate court will review the agency's "final decision," not arguments the Auditing Division made before the Tax Commission, or a phantom Decision the Tax Commission could have issued if their attorneys, rather than the Commission, had issued it.

the facts recited between pages 13 and 17 of the Tax Commission's brief can be found in the Tax Commission's Findings of Fact in the Final Decision. The Tax Commission, again as distinguished from its brief on appeal, apparently felt that whatever representations Reese Davis and others made were not helpful in deciding whether Broadcast granted "possession, use or operation" of the equipment to its subscribers.

A. The Testimony of Reese Davis is the reverse of what the Tax Commission now claims.

Assuming, however, that the selective quotations recited as "fact" in the Tax Commission's brief, again as distinguished from the Tax Commission's Final Decision, have relevance, the Tax Commission's brief badly distorts them. For example, the Tax Commission quotes Reese Davis, Broadcast's Treasurer, as stating that "I did not want them [the taxing jurisdictions outside Utah] to believe in any way, shape, or form that we had sold the equipment in a commercial sense, i.e. conveyed title." Respondent's Brief at 14, Hearing Tr. lines 15-22 (emphasis added).

In this quotation, Reese Davis said precisely what he meant - that title to the equipment had not passed to the subscriber and that therefore no sale "in the commercial sense" had occurred. The Tax Commission's brief twists this nearly self-evident explanation to conclude that Broadcast consumed the equipment it purchased. In contrast, the Tax Commission's Final Decision recognizes that Broadcast would have "sold" its equipment (for sales and use tax purposes) had it granted "the right of possession, operation or use" of the equipment to its subscribers, even though title did not pass.

A similar point can be made about Reese Davis' observation that "we [Broadcast] would be consuming, using and operating the equipment to the extent provided by our contracts of that equipment outside of the State of Utah." Respondent's Brief at 15, quoting Hearing Tr. 131 (emphasis added). By this statement Reese Davis did not mean the subscriber had no right to possess, operate and use the equipment. Broadcast indeed had certain rights, but the subscriber had the "right to possession, operation or use" of the equipment, which are the only "rights" which count here. Hearing Tr. 132 (Broadcast bought the equipment with a "resale intention").

B. The Tax Commission twists the undisputed facts of the case to claim that the subscriber's possession of the equipment is insignificant.

The Tax Commission distorts other facts, including:

1. The Tax Commission claims the equipment would have no independent value without Broadcast's services. Respondent's Brief at 21. This assertion is not "fact," it is conjecture. As explained infra, under Young, this conjecture, even if true, is not relevant. More to the point here, however, is that the conjecture is false. John Lasater testified SaveMart uses Broadcast's equipment for check authorization and verification, a service Broadcast does not provide. Hearing Tr. at 103-106. There was no contrary testimony.

2. The Tax Commission claims the "ration [sic] of [services to equipment is] nearly 13 to 1." Respondent's Brief at 21. Reese Davis testified to the contrary, that "50 percent of cash flow from this contract goes to pay equipment costs and expenses." Hearing Tr. at 158. This conclusion was uncontroverted and is based upon net present value of cash flows.

In summary, the Tax Commission's brief quotes snippets of testimony, and attributes a self-serving meaning to them which the witnesses expressly denied under oath.

C. Broadcast's transfer of tangible personal property to its subscribers cannot lawfully be disregarded simply because Broadcast also sells them a service.

The Tax Commission repeatedly states that Broadcast has not granted possession, operation or use of the equipment to its subscribers because it sold them a service. The faulty premise to this argument is that the two (a sale of service and a sale of property) are mutually exclusive. Young, discussed infra, is to the contrary.[16] The Tax Commission's reliance on three cases[17] for support of this premise is particularly illogical because the facts of those cases are inapposite to the undisputed facts here.

1. White held that a charge assessed cable subscribers for converters was not for the rent of tangible personal property and was not subject to Alabama's rental tax. The taxpayer in White offered "Tier service," which made available additional programming to that offered through basic service. For those subscribers with conventional televisions, a converter was necessary to receive Tier service. "Cable-ready" televisions in White had so proliferated that the taxpayer was hard pressed to make an argument that it sold tangible personal property when most of its customers did not need a "converter."

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[16] Mark O. Haroldsen, Inc. v. State Tax Commission, 805 P.2d 176 (1990) is also to the contrary. Haroldsen held that the sale of computerized lists (an intangible) was nonetheless taxable because it was tied to the sale of tangible property.

[17] White v. Storer Cable Communications, 507 So. 2d 964 (Ala. Civ. App. 1987); BJ-Titan Services v. State Tax Commission, 842 P.2d 822 (Utah 1992); Hardy v. Utah State Tax Commission, 561 P.2d 1064 (Utah 1977).

In this case, however, all witnesses speaking on the subject testified it was impossible to receive Broadcast's services without the equipment. The de minimus value of the converters in White, from $40 to $105, cannot logically or honestly be equated with the value of Broadcast's equipment, which is 50% of the contract's net present value. Testimony of Reese Davis, Hearing Tr. at 158.

2. BJ-Titan Services v. State Tax Commission states that "the essence of the transaction" test does not apply when severable tangible personal property is used "in the process of . . . rendering services." Id. at 825. Under such circumstances, the issue is "who is the ultimate user or consumer of the tangible personal property," and who, as a result, should pay the sales or use tax. Id. Like the auto mechanic example in BJ-Titan, Broadcast installs tangible personal property without alteration. Thus the tax should be, and has been, paid by the subscriber (or by Broadcast for the subscriber) to its taxing jurisdiction. Moreover, Utah Code Ann. § 59-1-610(1) overrules BJ-Titan to the extent it gives deference to the Tax Commission's decision on what constitutes the "essence of the transaction."

3. Hardy v. Utah State Tax Commission holds that dentists are consumers of the materials they use in fixing teeth. They must then either separate materials from services or collect a sales tax from their patient on the value of materials and services. Broadcast, however, consumes nothing. Again, unlike the dentists in Hardy, Broadcast installs the equipment without alteration.

III. THE TAX COMMISSION HAS DISREGARDED STATUTES AND CASE LAW DIRECTLY ON POINT TO TAX BROADCAST.

A. Utah Code Ann. § 59-12-102(10)(e) cannot be disregarded by the Tax Commission as "inoperative."

In its analysis of Section 59-12-102(10)(e), the Tax Commission's brief, again as distinguished from the Tax Commission's Final Decision, makes the outlandish argument that the statute has "no operative effect." Respondent's Brief at 18. This argument cannot be taken seriously. If, to illustrate, Section 59-12-102(10)(e) "has no operative effect," there is no authority to tax lease payments in which tangible personal property, but not title, is transferred from one to another.[18]

B. Young Electric Sign v. Utah State Tax Commission is directly on point in Broadcast's favor.

The Tax Commission's arguments in this case are demonstrably Machiavellian in light of case law directly on point. In 1955, the Tax Commission successfully argued in Young Electric Sign v. Utah State Tax Commission, 291 P.2d 900 (Utah 1955) that Young's transfer of possession of an electric sign from itself to its customer was a taxable sale under the predecessor to Section 59-12-102(10)(e), even though Young retained title to the sign. Significantly, the Tax Commission's Final Decision in this case does not mention Young, even though the case was extensively briefed. Apparently, it is easier to tax Broadcast if it is assumed Young does not exist.

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[18] If the facts of this case were slightly different, and a "seller" granted the right to "possession, operation, or use" of its property to in-state rather than out-of-state "purchasers," would the Tax Commission still argue, as it does here, that such a transaction is not a taxable sale? We think not.

The Tax Commission's brief offers a flawed analysis of Young. To begin, the Tax Commission correctly notes the two principal issues in Young: (1) whether some of Young's customers could be charged a sales tax for materials sold incidentally with services; and (2) whether a sales tax could be imposed upon Young's rental agreements with other customers. From a fair framing of the issues, however, the Tax Commission's analysis takes a crooked path.

As to Issue 1, the Supreme Court held the Tax Commission had erred in imposing a tax on materials Young used in repair and maintenance of its signs, because they were incidental to the sale of service. The Tax Commission's brief concludes from this straightforward holding that Young is "relevant and controlling" (Respondent's Brief at 31) in this case. This conclusion cannot possibly be true from Young's facts, which, again significantly, the Tax Commission's brief omits. They are that "The customers did not obtain the right of possession or use of the sign as a result of such repair; they were the owners of the signs before the repairs were made." Id. at 902 (emphasis added). In this case, Broadcast's customers were never "title owners" of the equipment, as the Tax Commission never wearies from telling us elsewhere in its memoranda. Further, Broadcast has never argued that its maintenance of the equipment amounted to a grant of possession. The Tax Commission's analysis of Young is thus irreconcilably inconsistent with arguments it elsewhere advances, and, once again, evinces a strong pro-tax bias.

Young's customers for Issue 1 were sign owners; for Issue 2 they were not. On Issue 2, the Supreme Court held that Young's

transfer of possession of the signs under rental contracts was taxable. Broadcast relies upon this holding because it construes the predecessor statute to Section 59-12-102(10)(e) under similar circumstances to conclude that Young's transfer of tangible personal property to its customers was taxable. The Tax Commission cavalierly dismisses Young with the argument that "the principal transaction was the rental of the electric sign," whereas Broadcast's principal transaction was "providing services, not equipment." Respondent's Brief at 32. This is a fabricated distinction, which, even if true, is irrelevant. In Young, the customer had the right to advertise on Young's sign, just as in this case the subscriber has the right to advertise on Broadcast's equipment. Young also had a "service agreement" with its customer, just as in this case. The essential fact, however, was that in Young, "there is a transfer of the right to continuous possession of personal property," id. at 903, just as in this case. The only significant distinction between Young and this case is that Broadcast transferred possession of tangible personal property to its subscribers outside of Utah, which means that those sales are not taxable by Utah. Had Broadcast transferred possession of the equipment to its subscribers in Utah, we doubt the Tax Commission would be arguing such transfers of tangible personal property would not be taxable Utah sales.

Finally, Young exposes the intellectual shallowness in the Tax Commission's argument that Section 59-12-102(10)(e) can be disregarded as "inoperative," or that it need not be enforced because it is not part of a "comprehensive" taxing scheme. Respondent's Brief at 18.

IV. THE NEGLIGENCE PENALTY IS AN ABUSE OF THE TAX COMMISSION'S POWER.

The Tax Commission's Final Decision justifies a "negligence penalty" on the ground that Broadcast has been "inattentive to its responsibilities" and has taken "inconsistent positions with respect to its in-state and out-of-state tax liabilities." Final Decision at 18. There are at least two defects in this analysis. First, the Tax Commission's Final Decision does not mention, much less apply, Chicago Bridge & Iron Company v. Utah State Tax Commission, 839 P.2d 303 (Utah 1992) to determine whether Broadcast had a "good faith" argument against taxation. This, in itself, is manifest error. Second, the Tax Commission, in claiming that Broadcast had been "inconsistent" with respect to its "in-state" and "out-of-state" transactions, necessarily assumes that it is competent to determine the law of other jurisdictions. This is irreconcilable with the Hearing Officer's ruling that Anna Andersen was not competent to testify about the law of other jurisdictions, and his exclusion of such testimony. Hearing Tr. at 362.

The Tax Commission's brief, again as distinguished from the Tax Commission's Final Decision, for the first time, responds to Broadcast's "good faith" defense against the negligence penalty. The argument is that "at the time [Broadcast] failed to pay sales taxes, it did not have a good faith basis to do so." Respondent's Brief at 42. This argument is badly flawed, this time for three reasons. First, it is factually incorrect and cannot be reconciled with the Final Decision. To reiterate, the Tax Commission's Final Decision found Broadcast issued an exemption certificate to its Utah vendor, which evinced a contemporaneous

intent that Broadcast claimed its purchases of the equipment in Utah were nontaxable sales for resale. Second, Broadcast paid sales or use taxes to approximately 800 taxing jurisdictions throughout the United States in reliance upon advice from Vertex Tax Advisors, Inc. that "BI is in total compliance and has stood the test of any state audit that has been conducted." Petitioner's Hearing Exhibit P-22, p.1. Third, the Auditing Division would have imposed a negligence penalty under any circumstances, even in the face of a good faith defense.[19]

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[19] The following exchange demonstrates that the negligence penalty was imposed in an overzealous disregard of established law:

> Q [by Mr. Miller] Now, if Broadcast's argument is meritorious, even though you may consider it wrong, would you still think a negligence penalty would be justified?
>
> A [by Ms. Andersen] Yes, because petitioner should have exercised care in coming -- because they made such a major change in how they accounted for the tax. . .
>
> . . . .
>
> Q Suppose they had consulted with you and they just came away saying: "Look, Anna, we disagree with you." Would you still have imposed a negligence penalty?
>
> A Yes.

Deposition of Anna Andersen at 35.

CONCLUSION

The Tax Commission's Decision and brief prompt recall of the Danish proverb that "Lawyers and painters can soon change white to black."[20] This is an easy case. The Tax Commission's Decision should be reversed because it holds that Broadcast granted its subscribers no "right to possession, operation, or use" of its equipment, even though, as both parties to the agreement testified, the subscribers possess, operate and use the equipment as granted to them by contract. No honest and reasonable definition of the "right to possession, operation or use" granted by contract can possibly justify the Tax Commission's Decision. This Court should not permit the Tax Commission to tax Broadcast by claiming that white is really black.

DATED this 7th day of January, 1994.

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[20] J. Brallier, Lawyers and Other Reptiles 26 (Contemporary Books ed. 1992).

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of January, 1994, I caused to be mailed, first class, postage prepaid, a true and correct copy of the foregoing REPLY BRIEF OF PETITIONER, to:

Janet C. Graham
Attorney General
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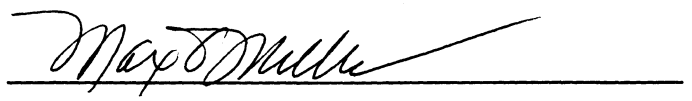

Appendix A

APPENDIX A

TEXT OF CONSTITUTIONAL PROVISIONS, STATUTES AND RULES

1. United States Constitution, Article I, Section 8, Clause 3

> [3.] To regulate commerce with foreign nations, and among the several States, and with the Indian Tribes;

2. Utah Code Ann. § 59-12-103(1)(a) (1987)

> (1) There is levied a tax on the purchaser for the amount paid or charged for the following:
>
> (a) retail sales of tangible personal property made within the state;

3. Utah Code Ann. § 59-12-103(1)(l) (1987)

> (1) There is levied a tax on the purchaser for the amount paid or charged for the following:
>
> . . .
>
> (l) tangible personal property stored, used, or consumed in this state.

4. Utah Code Ann. § 59-12-102(8)(a) (1987)

> As used in this chapter:
>
> . . .
>
> (8)(a) "Retail sale" means any sale within the state of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), other than resale of such property, item, or service by a retailer or wholesaler to a user or consumer.

5. Utah Code Ann. § 59-12-102(10) (1987)

> As used in this chapter:
>
> . . .
>
> (10) "Sale" means any transfer of title, exchange, or barter, conditional or otherwise in any manner,

of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), for a consideration. It includes:

(a) installment and credit sales;

(b) any closed transaction constituting a sale;

(c) any sale of electrical energy, gas, services, or entertainment taxable under this chapter;

(d) any transaction if the possession of property is transferred but the seller retains the title as security for the payment of the price; and

(e) any transaction under which right to possession, operation, or use of any article of tangible personal property is granted under a lease or contract and the transfer of possession would be taxable if an outright sale were made.

6. Utah Code Ann. § 59-12-102(12) (1987)

(12) "Storage" means any keeping or retention of tangible personal property or any other taxable item or service under Subsection 59-12-103(1), in this state for any purpose except sale in the regular course of business.

7. Utah Code Ann. § 59-12-102(14)(a)

(14)(a) "Use" means the exercise of any right or power over tangible personal property under Subsection 59-12-103(1), incident to the ownership or the leasing of that property, item, or service.

8. Utah Code Ann. § 59-12-104(28) (1987)

The following sales and uses are exempt from the taxes imposed by this chapter:

. . .

(28) property upon which a sales or use tax was paid to some other state, or one of its subdivisions, except that the state shall be paid any difference between the tax paid and the tax imposed by this part and Part 2, and no adjustment is allowed if the tax paid was greater than the tax imposed by this part and Part 2;

9. Utah Code Ann. § 59-1-801 (1987)

ARTICLE V. ELEMENTS OF SALES AND USE TAX LAWS
Tax Credit

1. Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another state and any subdivision thereof. The credit shall be applied first against the amount of any use tax due the state, and any unused portion of the credit shall then be applied against the amount of any use tax due a subdivision. Exemption Certificates, Vendors May Rely

2. Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate state or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction.

10. Utah Code Ann. § 59-1-610(1)(b) (1993)

(1) When reviewing formal adjudicative proceedings commenced before the commission, the Court of Appeals or Supreme Court shall:

(b) grant the commission no deference concerning its conclusions of law, applying a correction of error standard, unless there is an explicit grant of

discretion contained in a statute at issue before the appellate court.

11. Utah Code Ann. § 63-46b-16(1) (1987)

> (1) As provided by statute, the Supreme Court or the Court of Appeals has jurisdiction to review all final agency action resulting from formal adjudicative proceedings.

12. Utah Code Ann. § 78-2-2(4) (1992)

> (4) The Supreme Court may transfer to the Court of Appeals any of the matters over which the Supreme Court has original appellate jurisdiction, except: . . .

13. Utah Code Ann. § 78-2a-3(2)(k) (1992)

> (2) The Court of Appeals has appellate jurisdiction, including jurisdiction of interlocutory appeals, over:
>
> . . .
>
> (k) cases transferred to the Court of Appeals from the Supreme Court.

14. Rule R865-19-23S

A. Taxpayers selling tangible personal property or services to exempt customers are required to keep records verifying the nontaxable status of such sales. Records shall include:

1. sales invoices showing the name and identity of the customer, and

2. exemption certificates for exempt sales of tangible personal property or services if the exemption category is shown on the exemption certificate forms or if the sale is to a government agency, and the total sale is $100 or less.

B. The Tax Commission will furnish samples of acceptable exemption certificate forms on request. Stock quantities are not furnished, but taxpayers may reproduce samples as needed in whole or in part.

C. Exemption certificates are not required for sales to qualified government agencies (federal, state, counties, and cities--including schools), but the vendor must keep a purchase order or other acceptable evidence of exemption, such as a copy of a check or voucher.

D. If a purchaser is unable to segregate tangible personal property or services which he purchases for resale from tangible personal property or services which he purchases for his own consumption, everything should be purchased tax-free. He must then report and pay the tax on the cost of goods or services purchased tax-free for resale but which are used or consumed.

E. The burden of proving that a sale is for resale or otherwise exempt is upon the person who makes the sale. If any agent of the Tax Commission requests the vendor to produce a valid exemption certificate or other similar acceptable evidence to support the vendor's claim that a sale is for resale or otherwise exempt, and the vendor is unable to comply, the sale will be considered taxable and the tax shall be payable by the vendor.

15. Rule 865-19-92S

A. Definitions:

1. "Canned computer software" or "prewritten computer software" means a program or set of programs that can be purchased and used without modification and has not been prepared at the special request of the purchaser to meet their particular needs.

2. "Custom computer software" means a program or set of programs designed and written specifically for a particular user. The program must be customer ordered and can incorporate preexisting routines utilities or similar program components. The addition of a customer name or account titles or codes will not constitute a customer program.

3. "Computer-generated output" means the microfiche, microfilm, paper, discs, tapes, molds, or other tangible personal property generated by a computer.

4. "License agreement" means the same as a lease or rental of computer software.

B. The sale, rental or lease of canned or prewritten computer software constitutes a sale of tangible personal property and is subject to the sales or use tax. Payments under a license agreement are taxable as a lease or rental of the software package. Charges for program maintenance, consultation in connection with a sale or lease, enhancements, or upgrading of canned or prewritten software are taxable.

C. The sale, rental or lease of custom computer software is exempt from the sales or use tax, regardless of the form in which the program is transferred. Charges for services such as program maintenance, consultation in connection with a sale or lease, enhancements, or upgrading of custom software are not taxable.

D. Charges for services to modify or adapt canned computer software or prewritten computer software to a purchaser's needs or equipment are not taxable if the charges are separately stated and identified.

E. The sale of computer generated output is subject to the sales or use tax if the primary object of the sale is the output and not the services rendered in producing the output.

F. This rule cites the most common types of transactions involving computer software and it should not be construed to be inclusive but merely illustrative in nature.